

1975 ANNUAL REPORT OF THE BOARD
OF TRUSTEES OF THE FEDERAL
SUPPLEMENTARY MEDICAL
INSURANCE TRUST FUND

COMMUNICATION

FROM

BOARD OF TRUSTEES
FEDERAL SUPPLEMENTARY MEDICAL
INSURANCE TRUST FUND

TRANSMITTING

THE 1975 ANNUAL REPORT OF THE BOARD, PURSUANT TO
SECTION 1841(b) OF THE SOCIAL SECURITY ACT, AS
AMENDED



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1975 ANNUAL REPORT OF THE BOARD OF
TRUSTEES OF THE FEDERAL
SUPPLEMENTARY MEDICAL INSURANCE
TRUST FUND

LETTER

FROM

BOARD OF TRUSTEES
FEDERAL SUPPLEMENTARY MEDICAL INSURANCE
TRUST FUND

TRANSMITTING

The 1975 Annual Report of the Board (10th Report)
Pursuant to the Provisions of Section 1841(b)
of the Social Security Act, as Amended

LETTER OF TRANSMITTAL

BOARD OF TRUSTEES OF THE FEDERAL
SUPPLEMENTARY MEDICAL INSURANCE TRUST FUND,
Washington, D.C., May 2, 1975.

The SPEAKER OF THE HOUSE OF REPRESENTATIVES,
Washington, D.C.

SIR: We have the honor to transmit to you the 1975 Annual Report of the Board of Trustees of the Federal Supplementary Medical Insurance Trust Fund (the tenth such report), in compliance with the provisions of section 1841(b) of the Social Security Act, as amended.

Respectfully,

WILLIAM E. SIMON,
*Secretary of the Treasury,
and Managing Trustee of the Trust Funds.*

JOHN T. DUNLOP,
Secretary of Labor.

CASPAR W. WEINBERGER,
*Secretary of Health,
Education, and Welfare.*

JAMES B. CARDWELL,
Commissioner of Social Security.

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1975 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL SUPPLEMENTARY MEDICAL INSURANCE TRUST FUND

THE BOARD OF TRUSTEES

The Federal Supplementary Medical Insurance Trust Fund, established on July 30, 1965, is held by the Board of Trustees under the authority of section 1841(b) of the Social Security Act, as amended. The Board is comprised of three members who serve in an ex-officio capacity. The members of the Board are the Secretary of the Treasury, the Secretary of Labor, and the Secretary of Health, Education, and Welfare. The Secretary of the Treasury is designated by law as the Managing Trustee. The Commissioner of Social Security is Secretary of the Board. The Board of Trustees reports to the Congress once each year, in compliance with Section 1841(b)(2) of the Social Security Act. This Report is the annual report for 1975, the tenth such report.

HIGHLIGHTS

(a) In July 1973, persons entitled to disability insurance benefits for two years and persons suffering from chronic kidney disease became eligible to enroll in the supplementary medical insurance program. Based on the partial data now available, it appears that fiscal year 1974 outlays for these persons were close to that projected in the 1974 Report.

(b) The growth of the supplementary medical insurance trust fund during fiscal 1974 was somewhat higher than estimated in the 1974 Report. Income for fiscal 1974 of \$3.8 billion was up about 31 percent from fiscal 1973. Expenditures for benefit payments and administration were \$3.3 billion, an increase of about 24 percent over those for fiscal 1973. The cash balance of the trust fund grew by \$526 million to reach \$1,272 million by the end of fiscal 1974. Most of this increase was required to meet the liabilities for incurred but unpaid claims (and related administrative expenses) for disabled enrollees, first covered in July 1973.

(c) The solvency of the trust fund, which must be measured on an incurred basis, also improved during fiscal 1974. Although incurred data for the newly covered beneficiaries is too incomplete to permit a fully accurate assessment, it appears that the assets of the program exceeded the liabilities for incurred but unpaid services and administrative costs at the end of fiscal year 1974.

(d) In December 1974, adequate actuarial rates of \$7.50 for aged enrollees and \$18.50 for disabled enrollees were promulgated for fiscal year 1976. Due to a technical error in the law, it was necessary to continue the 1975 premium rate of \$6.70 through 1976. Proposed legislation to correct this error has been submitted to the Congress.

Appendix A gives a statement of the actuarial assumptions and bases employed by the Secretary of Health, Education, and Welfare in determining these rates.

(e) The number of aged enrollees had by July 1974 reached 21.2 million, about 95 percent of the total population aged 65 and over. Disabled enrollment was 1.8 million in the same month.

NATURE OF THE TRUST FUND

The Federal supplementary medical insurance trust fund was established on July 30, 1965, as a separate account in the United States Treasury to hold the amounts accumulated under the supplementary medical insurance program. All the financial operations which relate to the system of supplementary medical insurance are handled through this fund.

The major sources of receipts of the trust fund are (1) premiums paid by eligible persons who are voluntarily enrolled in the program and (2) contributions of the Federal government that are authorized to be appropriated and transferred from the general fund of the Treasury. Eligible persons aged 65 and over have been able to enroll in the program since its inception in July 1966. Since July 1973, disabled persons under age 65, who meet certain eligibility requirements, have also been able to enroll in the program.

The premiums paid by participants are based on the standard monthly premium rate, which is the same for participants aged 65 and over and for disabled participants under age 65. Premiums paid for fiscal years 1967 through 1973 were matched by an equal amount of Government contributions. Beginning with fiscal year 1974, the amount of Government contributions corresponding to premiums paid by each of the two groups of participants is determined by applying a ratio, prescribed in the law for each group, to the amount of premiums received from that group of participants. The ratio is equal to (1) twice the amount of the adequate actuarial rate applicable to the particular group of participants, minus the amount of the standard monthly premium rate, divided by (2) the amount of the standard monthly premium rate.

Standard monthly premium rates and adequate actuarial rates are promulgated each year by the Secretary of Health, Education, and Welfare. The standard premium rates in effect since the beginning of the program, July 1966, through June 1975, and the rate promulgated for fiscal year 1976, are shown in table 1. Adequate actuarial rates in effect for fiscal years 1974 and 1975, and the rates promulgated for fiscal year 1976, are also shown.

Another source from which receipts of the trust fund are derived is interest received on investments held by the fund. The investment procedures of the fund are described later in this section.

Section 201(i) of the Social Security Act authorizes the Managing Trustee to accept and deposit in the trust fund unconditional money gifts or bequests made for the benefit of the fund or for any activity financed through the fund.

Expenditures for benefit payments and administrative expenses under the program are paid out of the trust fund. All expenses incurred by the Department of Health, Education, and Welfare and by the Treasury Department in carrying out the supplementary

medical insurance provisions of Title XVIII of the Social Security Act are charged to the trust fund. The Secretary of Health, Education, and Welfare certifies benefit payments to the Managing Trustee, who makes the payment from the trust fund in accordance therewith.

Hospitals, at their option, are permitted to combine their billing for both hospital costs and physician components of radiology and pathology services rendered hospital inpatients by hospital-based physicians. Where hospitals elect this billing procedure, payments are made initially from the hospital insurance trust fund, with reimbursement later to it from the supplementary medical insurance trust fund. The reimbursements so made are on a provisional basis and are subject to adjustment, with appropriate interest allowances, as the actual experience develops and is analyzed.

The Social Security Amendments of 1967 and 1972 authorize the Secretary of Health, Education, and Welfare to develop and conduct a broad range of experiments and demonstration projects designed to determine various methods of increasing efficiency and economy in providing health care services, while maintaining the quality of such services, under the hospital insurance and supplementary medical insurance programs. The costs of such experiments and demonstration projects are paid out of the hospital insurance and supplementary medical insurance trust funds.

Congress has authorized expenditures from the trust funds for construction, rental, and lease or purchase contract of office buildings and related facilities for the Social Security Administration. Both the capital costs of construction financed directly from the trust funds and the rental, lease, or purchase contract costs of acquiring facilities are included in trust fund expenditures. In 1974, construction of several large facilities was begun under purchase contract authority, wherein initial capital costs are borne by the private sector. Under this method of facilities acquisition, trust fund expenditures for use and ultimate Government ownership of a facility are made over periods of from 10 to 30 years. Whatever the manner of acquisition, the net worth of facilities and other fixed capital assets is not carried in the statements of the operations of the trust fund presented in this report. This is because the value of fixed capital assets does not represent funds available for benefit or administrative expenditures, and therefore is not viewed as being a consideration in assessing the actuarial status of the funds.

That portion of the trust fund which, in the judgment of the Managing Trustee, is not required to meet current expenditures for benefits and administration is invested in interest-bearing obligations of the United States Government (including special public-debt obligations described below), in obligations guaranteed as to both principal and interest by the United States, or in certain federally-sponsored agency obligations that are designated in the laws authorizing their issuance as lawful investments for fiduciary and trust funds under the control and authority of the United States or any officer of the United States. Obligations of these types may be acquired on original issue at the issue price or by purchase of outstanding obligations at their market price.

The Social Security Act authorizes the issuance of special public-debt obligations for purchase exclusively by the trust fund. The law requires that such special public-debt obligations shall bear interest

at a rate based on the average market yield (computed by the Managing Trustee on the basis of market quotations as of the calendar month next preceding the date of such issue) on all marketable interest-bearing obligations of the United States forming a part of the public-debt which are not due or callable until after the expiration of four years from the end of such calendar month.

TABLE 1.—STANDARD MONTHLY PREMIUM RATES AND ADEQUATE ACTUARIAL RATES

Period	Standard monthly premium rate	Adequate actuarial rate	
		Participants aged 65 and over	Disabled participants under age 65
July 1966–March 1968	\$3.00		
April 1968–June 1970	4.00		
Fiscal year:			
1971	5.30		
1972	5.60		
1973	5.80		
1974 ¹	6.30	\$6.30	\$14.50
1975	6.70	6.70	18.00
1976	6.70	7.50	18.50

¹ In accordance with limitations on the costs of health care imposed under phase III of the economic stabilization program, the standard premium rate for July and August 1973 was set at \$5.80 and \$6.10, respectively. Effective September 1973, the rate increased to \$6.30.

SUMMARY OF THE OPERATIONS OF THE TRUST FUND, FISCAL YEAR 1974

A statement of the income and disbursements of the Federal supplementary medical insurance trust fund during fiscal year 1974 and of the assets of the fund at the beginning and end of the fiscal year is presented in table 2. Comparable amounts for fiscal year 1973 are also shown in the table.

The total assets of the trust fund amounted to \$746 million on June 30, 1973. During fiscal year 1974, total receipts amounted to \$3,809 million and total disbursements were \$3,283 million. Total assets thus increased \$526 million during the year to a total of \$1,272 million on June 30, 1974.

Of the total receipts, \$1,579 million represented premium payments by (or on behalf of) participants aged 65 and over, and \$125 million represented premium payments by (or on behalf of) disabled participants under age 65. Total premium payments amounted to \$1,704 million, an increase of 19.5 percent over premium payments by participants in the preceding fiscal year. This increase in premiums from participants resulted primarily from (1) premiums paid by disabled participants under age 65, whose premiums first became payable in July 1973, (2) the increase from \$5.80 to \$6.30 per month in the standard premium rate that became effective during fiscal year 1974, and (3) the expected growth in the number of persons aged 65 and over enrolled in the supplementary medical insurance program.

Contributions received from the general fund of the Treasury amounted to \$2,029 million. This amount consisted of \$1,577 million representing contributions relating to premiums paid by participants aged 65 and over and \$452 million representing contributions relating to premiums paid by disabled participants under aged 65.

Reference has been made in an earlier section to provisions under which money gifts or bequests may be deposited in the trust fund.

In fiscal year 1974, the trust fund received gifts amounting to about \$4,000.

The remaining \$76 million of receipts consisted almost entirely of interest on the investments of the trust fund.

Of the \$3,283 million in total disbursements, \$2,868 million represented benefits paid directly from the trust fund for health services covered under Title XVIII of the Social Security Act. In addition, transfers were made to the hospital insurance trust fund consisting of \$6 million for inpatient professional radiology and pathology services that were paid initially from the hospital insurance trust fund but that are liabilities of the supplementary medical insurance trust fund. Total benefit payments from the trust fund in fiscal year 1974, therefore, amounted to \$2,874 million, an increase of 20.2 percent over the corresponding amount paid in fiscal year 1973.

Reference has been made in an earlier section to provisions which authorize payment from the trust fund for costs of experiments and demonstration projects in providing health care services. In fiscal year 1974, payments for such costs amounted to about \$47,000.

The remaining \$409 million of disbursements was for net administrative expenses. Administrative expenses are allocated and charged directly to each of the four trust funds—old-age and survivors insurance, disability insurance, hospital insurance, and supplementary medical insurance—on the basis of provisional estimates. Periodically, as actual experience develops and is analyzed, adjustments to the allocations of administrative expenses and costs of construction for prior periods are effected by interfund transfers, with appropriate interest allowances.

In table 3, the experience with respect to actual amounts of participants' premiums, Government contributions, and benefit payments in fiscal year 1974 is compared with the estimates for fiscal year 1974 which appeared in the 1974 Annual Report of the Board of Trustees. The actual experience was relatively close to the estimates.

The assets of the trust fund at the end of fiscal year 1974 totaled \$1,272 million, consisting of \$1,231 million in the form of obligations of the United States Government and an undisbursed balance of \$41 million. Table 4 shows a comparison of the total assets of the fund and their distribution at the end of fiscal years 1973 and 1974. A comparison of the assets of the trust fund with liabilities for incurred but unpaid benefits (and related administrative expenses) is shown in a later section.

The net increase in the par value of the investments held by the fund during fiscal year 1974 amounted to \$531 million. New securities at a total par value of \$4,316 million were acquired during the fiscal year, through the investment of receipts and reinvestment of funds made available from the redemption of securities. The par value of securities redeemed during the year was \$3,785 million. Included in these amounts is \$3,758 million in certificates of indebtedness that were acquired and redeemed within the fiscal year.

The effective annual rate of interest earned by the assets of the supplementary medical insurance trust fund during fiscal year 1974 was 6.8 percent. The interest rate on public-debt obligations issued for purchase by the trust fund in June 1974 was 7½ percent, payable semiannually.

TABLE 2.—STATEMENT OF OPERATIONS OF THE SUPPLEMENTARY MEDICAL INSURANCE TRUST FUND DURING FISCAL YEARS 1973 AND 1974

[In thousands of dollars]

	Fiscal year—	
	1973	1974
Total assets of the trust fund, beginning of year.....	480,709	745,722
Receipts:		
Premiums from participants:		
Participants aged 65 and over.....	1,426,607	1,578,919
Disabled participants under age 65.....		125,452
Total premiums.....	1,426,607	1,704,371
Transfers from general fund of the Treasury:		
Government contributions:		
For premiums received from participants aged 65 and over.....	1,430,652	1,577,045
For premiums received from disabled participants under age 65.....		451,880
Total Government contributions.....	1,430,652	2,028,926
Less adjustment in interest received in prior fiscal year on delayed transfers of Government contributions.....	201	
Net transfers from general fund of the Treasury.....	1,430,451	2,028,926
Interest:		
Interest on investments.....	43,070	77,243
Interest on amounts of interfund transfers due to adjustment in allocation of administrative expenses and construction costs ¹	1,979	-1,318
Total interest.....	45,049	75,924
Gifts.....		4
Total receipts.....	2,902,106	3,809,225
Disbursements:		
Benefit payments:		
Paid directly from the trust fund for costs of health services.....	2,385,128	2,867,602
Transfers to the hospital insurance trust fund for reimbursement of payments made initially from that fund for costs of radiology and pathology services ²	6,000	6,000
Total benefit payments.....	2,391,128	2,873,602
Costs of experiments and demonstration projects ²	104	47
Administrative expenses:		
Department of Health, Education, and Welfare ³	269,887	379,319
Treasury Department.....	20	88
Railroad Retirement Board.....		814
Civil Service Commission.....	72	78
Construction of facilities for Social Security Administration.....	1,064	-72
Interfund transfers due to adjustment in allocation of—		
Administrative expenses ⁴	-24,953	28,881
Construction costs ⁴	-223	42
Gross administrative expenses.....	245,867	409,150
Less receipts from sale of surplus supplies, materials, etc.....	6	29
Net administrative expenses.....	245,861	409,121
Total disbursements.....	2,637,093	3,282,770
Net addition to the trust fund.....	265,014	526,455
Total assets of the trust fund, end of year.....	745,722	1,272,177

¹ A positive figure represents a transfer of interest to the supplementary medical insurance trust fund from the other social security trust funds. A negative figure represents a transfer of interest from the supplementary medical insurance trust fund to the other social security trust funds.

² For explanation, see text.

³ Includes administrative expenses of the carriers and intermediaries.

⁴ A positive figure represents a transfer from the supplementary medical insurance trust fund to the other social security trust funds. A negative figure represents a transfer to the supplementary medical insurance trust fund from the other social security trust funds.

TABLE 3.—COMPARISON OF ACTUAL AND ESTIMATED OPERATIONS OF THE SUPPLEMENTARY MEDICAL INSURANCE TRUST FUND, FISCAL YEAR 1974

[Dollar amounts in millions]

Item	Actual amount	Estimated amount published in 1974 report	Actual as percentage of estimate
Premiums from participants.....	\$1, 704	\$1, 683	101
Government contributions.....	2, 029	2, 008	101
Benefit payments.....	2, 874	2, 900	99

Note: In interpreting the figures in the above table, reference should be made to the accompanying text.

TABLE 4.—ASSETS OF THE SUPPLEMENTARY MEDICAL INSURANCE TRUST FUND, BY TYPE, AT THE END OF FISCAL YEARS 1973 AND 1974

	June 30, 1973		June 30, 1974	
	Par value	Book value ¹	Par value	Book value ¹
Investments in public-debt obligations sold only to this fund (special issues):				
Notes:				
5¼ percent, 1979.....	\$232, 150, 000	\$232, 150, 000.00	\$232, 150, 000	\$232, 150, 000.00
6½ percent, 1978.....	185, 719, 000	185, 719, 000.00	159, 101, 000	159, 101, 000.00
6½ percent, 1980.....	281, 762, 000	281, 762, 000.00	281, 762, 000	281, 762, 000.00
Bonds:				
7½ percent, 1981.....			61, 964, 000	61, 964, 000.00
7½ percent, 1982.....			61, 964, 000	61, 964, 000.00
7½ percent, 1983.....			61, 964, 000	61, 964, 000.00
7½ percent, 1984.....			61, 964, 000	61, 964, 000.00
7½ percent, 1985.....			61, 964, 000	61, 964, 000.00
7½ percent, 1986.....			61, 963, 000	61, 963, 000.00
7½ percent, 1987.....			61, 963, 000	61, 963, 000.00
7½ percent, 1988.....			61, 963, 000	61, 963, 000.00
7½ percent, 1989.....			61, 963, 000	61, 963, 000.00
Total investments in public-debt obligations.....	699, 631, 000	699, 631, 000.00	1, 230, 685, 000	1, 230, 685, 000.00
Undisbursed balances.....		46, 091, 485.58		41, 492, 279.79
Total assets.....		745, 722, 485.58		1, 272, 177, 279.79

¹ Par value, plus unamortized premium, less discount outstanding.

ADVISORY COUNCIL ON SOCIAL SECURITY

Pursuant to section 706 of the Social Security Act, an Advisory Council on Social Security was appointed by the Secretary of Health, Education, and Welfare in April 1974. The Council reports, submitted March 6, 1975, contained no recommendations regarding the supplementary medical insurance program.

EXPECTED OPERATIONS AND STATUS OF THE TRUST FUND DURING THE PERIOD JULY 1, 1974 TO SEPTEMBER 30, 1977

The projected cash income, disbursements, and balance of the trust fund during the period July 1, 1974 to September 30, 1977 are summarized in Table 5, along with a summary of the past transactions of the trust fund through June 30, 1974.

Income to the program is projected to increase by about 13% in fiscal year 1975 over fiscal 1974, due to the increase in the premium rate from \$6.30 per month for fiscal 1974 to \$6.70 per month for fiscal 1975, increased enrollment in the program, and increased government contributions for disabled enrollees. An increase of 16 percent is projected for fiscal 1976 over 1975.

Benefit expenditures for fiscal year 1975 are expected to increase by 27 percent over those for fiscal 1974. This increase is due partly to the fact that outlays for disabled beneficiaries in fiscal 1974 were depressed by normal first year payment lags. Benefit payments for fiscal year 1976 are expected to increase 16 percent over those for fiscal year 1975.

The estimate of benefit payments for fiscal year 1975 assume an average increase in reasonable charges of 8.5 percent above the 1974 level. Fiscal year 1976 reasonable charges are projected to increase 8.2 percent over 1975. This results from updating the reasonable and customary fees to the level charged in calendar year 1974 (as required by law) but with the restriction that prevailing fees not increase more than the increase of an economic index of wages and costs (required by P.L. 92-603).

Trust fund withdrawals for administrative expenses are expected to increase to \$420 million in fiscal year 1975. Fiscal 1976 administrative expenses are estimated to be \$515 million.

The trust fund balance is projected to increase from \$1,272 million at the beginning of fiscal 1975 to \$1,481 million at the end of that year, and to \$1,664 million at the end of fiscal 1976.

The progress of the trust fund is shown on a calendar year basis in Table 5A.

TABLE 5.—ESTIMATED PROGRESS OF SUPPLEMENTARY MEDICAL INSURANCE TRUST FUND (CASH BASIS), FISCAL YEARS 1975-77 AND ACTUAL DATA FOR 1967-74

[In millions of dollars]

Fiscal year	Pre- miums from partici- pants	Gov- ern- ment contri- butions ¹	Benefit payments	Adminis- trative expenses	Interest on fund	Total income	Total expendi- tures	Balance in fund at end of year ²
Actual experience:								
1967.....	647	623	664	³ 134	15	1,285	799	486
1968.....	698	634	1,390	143	21	1,353	1,532	307
1969.....	903	984	1,645	195	23	1,911	1,840	378
1970.....	936	928	1,979	217	12	1,876	2,196	57
1971.....	1,253	1,245	2,035	248	17	2,516	2,283	290
1972.....	1,340	1,365	2,255	288	29	2,734	2,544	481
1973.....	1,427	1,430	2,391	246	45	2,902	2,637	746
1974.....	1,704	2,029	2,874	409	76	3,809	3,283	1,272
Estimate of future experience:								
1975.....	1,868	2,329	3,661	420	93	4,290	4,081	1,481
1976.....	1,913	2,939	4,260	515	106	4,958	4,775	1,664
Interim ⁴	489	953	1,253	126	30	1,472	1,379	1,757
1977 ⁵	1,964	4,003	5,211	546	130	6,097	5,757	2,097

¹ The payments shown as being from the general fund of the Treasury include certain interest-adjustment items.

² Represents only a cash balance; financial status of the program depends on total net assets and liabilities of the program.

³ Administrative expenses shown include those paid in fiscal 1966 and 1967.

⁴ Interim period is period from July 1, 1976 to Sept. 30, 1976.

⁵ Fiscal year 1977 is period from Oct. 1, 1976 to Sept. 30, 1977.

TABLE 5A.—ESTIMATED PROGRESS OF SUPPLEMENTARY MEDICAL INSURANCE TRUST FUND (CASH BASIS), CALENDAR YEARS 1975-77 AND ACTUAL DATA FOR 1966-74

[In millions of dollars]

Calendar year	Premiums from participants	Government contributions ¹	Benefit payments	Administrative expenses	Interest on fund	Total income	Total expenditures	Balance in fund at end of year ²
Actual experience:								
1966.....	322	0	128	75	3	324	203	122
1967.....	640	933	1,197	110	24	1,597	1,307	412
1968.....	832	858	1,518	183	21	1,711	1,702	421
1969.....	914	907	1,865	196	18	1,839	2,061	199
1970.....	1,096	1,093	1,975	238	12	2,201	2,212	188
1971.....	1,302	1,313	2,117	260	24	2,639	2,377	450
1972.....	1,382	1,389	2,325	290	37	2,808	2,614	643
1973.....	1,550	1,705	2,526	318	57	3,311	2,844	1,111
1974.....	1,804	2,225	3,318	410	95	4,124	3,728	1,506
Estimate of future experience:								
1975.....	1,890	2,634	3,960	468	109	4,633	4,428	1,711
1976.....	1,936	3,355	4,635	520	125	5,416	5,155	1,972
1977.....	1,974	4,198	5,412	556	145	6,317	5,968	2,321

¹ The payments shown as being from the general fund of the Treasury include certain interest-adjustment items.² Represents only a cash balance; financial status of the program depends on total net assets and liabilities of the program.

ACTUARIAL STATUS OF THE TRUST FUND

1. Actuarial soundness of the supplementary medical insurance program

The concept of actuarial soundness, as it applies to the Supplementary Medical Insurance System, is closely related to the concept as it applies to private group insurance. The Supplementary Medical Insurance System is essentially yearly renewable term insurance; and in testing its actuarial soundness, it is not appropriate to look beyond the period for which the premium rate and the level of general revenue financing have been established.

The primary test of actuarial soundness relates to the adequacy of the income for fiscal years not yet completed, but for which the premium rate and the level of general revenue financing have been established. The income for such years should be sufficient to meet the benefits incurred and associated administrative expenses for the period. The law requires the Secretary of Health, Education, and Welfare to establish the income on this basis.

A second test of actuarial soundness is whether the trust fund assets, at the end of the period for which the premium rate and the level of general revenue financing have been established, will be as large as the liabilities—particularly those for services (and associated administrative expenses) that have been performed but for which reimbursement has not yet been made. This test will be met if the primary test of actuarial soundness has been met for all prior periods but it may not be met, even though the financing is currently adequate and the primary test is therefore met, if in the past the income was inadequate to meet incurred benefits and administrative expenses. In addition to the tests of actuarial soundness, a crucial consideration is that the trust fund never be in serious danger of becoming exhausted.

2. Incurred experience of the supplementary medical insurance program

Both of the tests of actuarial soundness of the Supplementary Medical Insurance program noted above rely on the incurred experience of the program. Cash disbursements for benefits and administrative expenses by themselves are misleading, due to the relatively large liabilities outstanding at any time for benefits and processing costs that must be paid for services already performed. These liabilities result from the lag between the time that services are performed and the time that benefits for them are paid, due to the tendency of enrollees to accumulate bills and submit them together (especially at the end of the year), and the time required by carriers to process and adjudicate the bills received. The liability outstanding at any time for benefits for services performed for which no payment has been made may be referred to as "benefits incurred but unpaid."

Estimates of the amount of benefits incurred but unpaid as of the end of each fiscal year, and of the administrative expenses related to processing these benefits, appear in Table 6.

TABLE 6.—SUMMARY OF ESTIMATED ASSETS AND LIABILITIES OF THE SUPPLEMENTARY MEDICAL INSURANCE PROGRAM, AT THE END OF FISCAL YEARS 1967-76—PAST EXPERIENCE

[In millions of dollars]

	As of June 30								Projected as of June 30	
	1967	1968	1969	1970	1971	1972	1973	1974	1975	1976
A. Assets:										
Balance in trust fund..	486	307	378	57	290	481	746	1,272	1,481	1,664
Government contributions due and unpaid.....	24	88	7	15	22	-3	-7	-5	30	-7
Total assets.....	510	395	385	72	312	478	739	1,267	1,511	1,657
B. Liabilities:										
Benefits incurred but unpaid.....	499	599	702	619	656	700	763	1,073	1,228	1,442
Administrative cost thereon.....	56	65	81	71	77	85	90	131	148	174
Total liabilities.....	555	664	783	690	733	785	853	1,204	1,376	1,616
C. Net surplus (or deficit).....	-45	-269	-398	-618	-421	-307	-114	63	135	41
D. Ratio of assets to liabilities.....	.92	.59	.49	.10	.43	.61	.87	1.05	1.10	1.03

The incurred experience of the program for any period is obtained by adjusting the cash flow of premiums, matching government contributions, interest, benefit payments, and administrative expenses to an accrual basis by adding the net increase in each asset or liability item during that period to the corresponding item on a "cash" basis. This procedure produces the estimated incurred income and disbursements shown in Table 7.

3. Adequacy of income in fiscal years 1975-76

The financing for the supplementary medical insurance program has been set by promulgation of the adequate actuarial rates and the standard premium rates by the Secretary through fiscal 1976 as described in Appendix A. Since enrollment is voluntary and both income and outgo change directly with enrollment—it is appropriate to assess the adequacy of such financing on a monthly per capita basis.

Table 8 compares the monthly income incurred per capita for fiscal years 1973-1976 with the estimated incurred expenditures. A minor deficiency is projected to occur in fiscal year 1976, which is acceptable in view of the anticipated surplus in the trust fund at the end of fiscal year 1975.

TABLE 7.—ESTIMATED INCOME AND DISBURSEMENTS INCURRED UNDER SUPPLEMENTARY MEDICAL INSURANCE PROGRAM, FISCAL YEARS 1967-76

[In millions of dollars]

Fiscal year	Premiums from participants	Government contributions	Benefit payments	Administrative expenses	Interest on fund	Net of operations in year
Past experience:						
1967.....	647	647	1,163	¹ 190	15	-44
1968.....	699	699	1,490	152	21	-223
1969.....	903	903	1,748	211	23	-130
1970.....	936	936	1,896	207	12	-219
1971.....	1,253	1,253	2,072	254	17	+197
1972.....	1,340	1,340	2,299	296	29	+114
1973.....	1,427	1,427	2,454	251	45	+194
1974.....	1,704	2,031	3,184	450	76	+177
Projected:						
1975.....	1,868	2,364	3,816	437	93	+72
1976.....	1,913	2,899	4,474	541	109	-94

¹ Includes administrative expenses incurred prior to the beginning of the program.

TABLE 8.—COMPARISON OF INCOME AND EXPENDITURES INCURRED PER CAPITA PER MONTH IN FISCAL YEARS 1973-76

Fiscal year	Income			Expenditures			Net
	Rate ¹	Interest	Total	Benefits	Administrative	Total	
Aged:							
1973.....	\$11.60	\$0.18	\$11.78	\$10.02	\$1.02	\$11.04	+\$0.74
1974.....	12.60	.26	12.86	10.71	1.52	12.23	+ .63
1975.....	13.40	.31	13.71	12.32	1.42	13.74	-.03
1976.....	15.00	.35	15.35	13.92	1.68	15.60	-.25
Disabled:							
1974.....	29.00	.54	29.54	24.58	3.49	28.07	1.47
1975.....	36.00	.62	36.62	29.68	3.41	33.09	3.53
1976.....	37.00	.75	37.75	34.70	4.20	38.90	-1.15

¹ Combined monthly premium and general revenue matching payments.

4. Accumulated surplus or deficit of the program

Table 6 shows the accumulated surplus or deficit at the end of fiscal years 1967 through 1976 and the ratio of the total assets to the outstanding liabilities at the end of each of these fiscal years.

The program developed a relatively modest deficit of about \$200 million during the first 1½ years due to an initial premium rate that proved to be about 8 percent low. The deficit increased further as a result of congressional action which retained the initial premium rate for an additional 3 months, through the first quarter of 1968. The deficit further increased by a relatively small amount during the next 15 months, during which the increased premium rate proved to be slightly low. The deficit accumulated by December 1969 was considered sufficiently manageable, so that the statutory provision for a contingency reserve available on a loan basis from the General Treasury that had been specifically authorized by Congress in view of the difficulties of forecasting the cost of the program was allowed to expire without being used.

The deficit grew substantially during fiscal year 1970 as a result of continuing the same premium rate as in the previous year, and as a result the trust fund was nearly exhausted. The adequate premium rates promulgated for the subsequent periods have substantially improved the financial position of the trust fund.

Reliable data on an incurred basis are not yet available for fiscal year 1974. Based on what is available, it appears that total assets exceeded total liabilities at the end of 1974. This surplus is projected to increase in 1975 and then be reduced slightly in 1976. Thus, under the current assumptions the program meets the second test of actuarial soundness described above during the period for which financing has been established.

5. Reliability of the estimates

Projections of the future income and disbursements of the SMI program are subject to forecasting errors. The principal reasons for errors are the uncertain nature of the trends in physicians' charges and institutional costs and the difficulty of predicting accurately changes in administrative policy. Over-all demand for covered services also fluctuates from year to year, as affected by epidemics, the weather, and many other causes. Further, due to inadequate data, the current cost of the program cannot be determined exactly, and the incurred cost as far back as 1972 must be estimated, with a possible error of a few percent.

Past experience demonstrates that cash expenditures for present enrollees can be estimated within a few percent for several future years. Due to incomplete data on an incurred basis, estimates of the future incurred experience for present enrollees are necessarily less reliable, and may vary from the actual experience. Estimates as to the cost of the new classes of beneficiaries are much less reliable because the data on which to establish historical costs are not yet available. Although a large relative error is possible in estimating the cost for these new beneficiaries, such an error would be relatively small compared to the overall size of the program.

CONCLUSION

The financing for the supplementary medical insurance program for fiscal years 1975 and 1976 has been established by the promulgation of premium rates of \$6.70 per month to be paid by enrollees and adequate actuarial rates which determine the amount to be contributed from general revenue on behalf of each enrollee. The income from these two sources plus interest earned on the investments of the fund is projected to exceed total outlays for benefits and administrative expenses in both fiscal 1975 and 1976 resulting in an increase in the trust fund of \$392 million over the two year period.

The assets of the program exceeded the liabilities for incurred but unpaid benefits (and related administrative expenses) at the end of fiscal year 1974, according to the best information available at this time. This slight surplus of assets over liabilities is projected to be maintained through the end of fiscal year 1976 based on the financing provisions already promulgated.